

COMMONWEALTH OF KENTUCKY  
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

ADJUSTMENT OF RATES OF BRENTWOOD )  
WASTE WATER TREATMENT PLANT, )  
INCORPORATED, TO BECOME EFFECTIVE ) CASE NO. 7594  
ON OCTOBER 20, 1979 )

O R D E R

Preface

On September 28, 1979, Brentwood Waste Water Treatment Plant, Inc., hereinafter referred to as the "Utility", filed with this Commission a duly verified application seeking an adjustment of its sewage rates, proposing an effective date of October 20, 1979.

The case was set for hearing at the Commission's Offices in Frankfort, Kentucky on December 13, 1979. All parties of interest were notified with the Consumer Protection Division of the Attorney General's Office and Brentwood Subdivision residents, by counsel, permitted to intervene in the matter. At the hearing, certain requests for additional information were made by the Commission Staff. Counsel for the Brentwood Subdivision residents also requested that they be allowed to examine the record and perhaps submit some interrogatories. Interrogatories were filed with this Commission December 27, 1979 with response to said interrogatories from the Applicant's counsel filed on January 25, 1979.

Pursuant to the conclusion that all requested information and other pertinent matters have been filed, the entire matter is now considered to be fully submitted for a final determination by this Commission.

Test Period

The Utility has selected the twelve month period ending June 20, 1979, as the "Test-Year" and has submitted tabulations of its revenues and expenses for this period including its proforma

adjustments thereto for the Commission's consideration in the determination of rate adjustments. Said tabulations along with those found reasonable by this Commission are included in Appendix "C" of this Order.

#### Rate Determination

While the Commission has traditionally considered the original cost of utility plant, the net investment, the capital structure, and the cost of reproduction as a going concern in the determination of fair, just, and reasonable rates its experience in the establishment or adjustment of rates for sewage utilities has indicated that these valuation methods are not always appropriate. Sewage utilities are unique to the extent that the cost of facilities has usually been included in the cost of the individual lot. The owner and/or operator of the utility is, in many instances, the developer of the real estate and title may have changed hands prior to the effective date of Commission jurisdiction (January 1, 1975). Further, the Commission has found that the books, records and accounts of these utilities are, for the most part, incomplete, so as to make impossible the fixing of rates on the above methods of valuation. The Commission is, therefore, of the opinion that the "Operating Ratio Method"<sup>(1)</sup> should be utilized in rate-making determinations for sewage utilities although it is recognized that there may be instances where the method would not be valid.

#### Findings in This Matter

The Commission, after consideration of all the evidence of record and being advised, is of the opinion and finds:

1. That, in this instance, the determination of rates and revenue requirements should be based on the operating ratio method.

2. That the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof, should produce annual revenues of approximately \$14,265 from 75 customers and is of the fair, just, and reasonable rate to be charged for sewage services rendered by the Utility, in the Brentwood Subdivision of Mercer County, Kentucky

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(1) Operating ratio is defined as the ratio of expenses, including depreciation and taxes to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating expenses} + \text{depreciation} + \text{taxes}}{\text{Gross Revenues}}$$

3. That an operating ratio of 0.88 results from the projected operations as adjusted and provides a reasonable return margin<sup>(2)</sup> in this instance.

4. That the rate proposed by the Utility is unfair, unjust, and unreasonable in that it would produce revenues in excess of those found reasonable herein and should be denied.

5. That the Utility has filed with this Commission a valid third-party beneficiary agreement.

6. That while traditionally depreciation on contributed property for rate-making purposes has been allowed, it has not been a matter of great significance in past years. The value of contributed property in currently operating water and sewage utilities, however, is frequently more than the value of investor financed property. Further, it is common practice for a builder or developer to construct water and sewage facilities that add to the value and salability of his subdivision lots and to expense this investment cost in the sale price of these lots or, as an alternative, to donate these facilities to a utility company.

It is also recognized that many residential and commercial developments in metropolitan areas are served by privately-owned sewage systems. Further, that federal guidelines will require the incorporation of these sewage systems into a regional comprehensive sewer district at such time as connecting trunk lines are made available. Further that to permit the accumulation of a depreciation reserve on contributed property that is to be abandoned would not, in our opinion, be in the public interest.

The Commission is, therefore, of the opinion and finds that depreciation on contributed property for water and sewage utilities is not justified and should not be included in rate-making determinations for these utilities. In support of this position and by way of substantiation, we make reference to the cases and decisions listed in Appendix "B", attached hereto and made a part hereof.

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(2) Return margin is the amount remaining for the payment of a return on the investment of the security holders.

7. That the Commission, after consideration of the tabulation of test-year and projected revenues and expenses submitted by the Utility, concludes that these revenues, expenses and adjustments can be summarized as shown in Appendix "C", attached hereto and made a part hereof. On the basis of the said Appendix "C" tabulation, the Commission further concludes that annual revenues in the amount of \$14,265 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal service to 75 customers.

Orders in This Matter

The Commission on the basis of the matters hereinbefore set forth and the evidentiary record in this case:

HEREBY ORDERS that the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof be and they are hereby fixed as the fair, just, and reasonable rates of the Utility for providing sewage disposal services to customers located in the Brentwood Subdivision, Mercer County, Kentucky, to become effective for services rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates sought by the Applicant be and the same are hereby denied.

IT IS FURTHER ORDERED that the Utility file with this Commission, within thirty (30) days from the date of this Order, its tariff sheets setting forth the rates approved herein. Further, that a copy of the Utility's Rules and Regulations for providing service to its customers shall be filed with said tariff sheets.

Done at Frankfort, Kentucky, this 5th day of March, 1980.

UTILITY REGULATORY COMMISSION

  
CHAIRMAN

  
VICE-CHAIRMAN

  
COMMISSIONER

ATTEST:

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SECRETARY

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7594 DATED MARCH 5, 1980

The following rates are prescribed for sewage disposal services rendered to all residential customers served by the Brentwood Waste Water Treatment Plant, Inc. in Brentwood Sub-division, in Mercer County, Kentucky:

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$15.85 per Residence
Multi-Family Residential	11.90 per Residence

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7594 DATED MARCH 5, 1980

A listing of cases and decisions that substantiate finding  
number 6.

- (1) 28 U.S.C. s 362(c) (1976).  
Dealing with the Basis to Corporations in Reorgani-  
zation. It states in part that property contributed  
by nonstockholders to a corporation has a zero basis.
- (2) Easter v. C.I.R., 338 F.2d 968 (4th Cir. 1964).  
Taxpayers are not allowed to recoup, by means of de-  
preciation deductions, an investment in depreciable  
assets made by a stranger.
- (3) Martigney Creek Sewer Co., (Mo. Pub. Serv. Comm.,  
Case No. 17,117) (November 26, 1971).  
For rate making purposes a sewer company should not  
be allowed to treat depreciation on contributed plant  
as an operating expense.
- (4) Re Incline Village General Improv. Dist., I & S 558,  
I & S 559, (Nev. Pub. Serv. Comm., May 14, 1970).  
Where a general improvement district sought to in-  
crease water rates, the Commission could not consider  
depreciation expense on the district's plant because  
all of the plant had been contributed by members of  
the district.
- (5) Princess Anne Utilities Corp. v. Virginia ex. rel.  
State Corp. Commission, 179 SE 2d 714, (Va. 1971).  
A depreciation allowance on contributions in aid of  
construction was not allowed to a sewer company  
operating in a state following the "original cost"  
rule in determining rate base because the company  
made no investment in the property, and had nothing  
to recover by depreciating the donated property.

APPENDIX "C"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7594 DATED MARCH 5, 1980

In accordance with Finding No. 7, the following tabulation is the Commission summary of the "Test-Year" and projected annual revenues and expenses for the Utility's 25,000 GPD sewage collection and treatment system for providing service to test-year and proforma customers.

	Test Year <sup>(1)</sup> Per Books	Proforma <sup>(1)</sup> Requested	Proforma Found Reasonable
(No. of Customers)	(13)	(60)	(75) <sup>(10)</sup>
<u>Revenues:</u>			
Monthly Service Fees	\$ 1,215	\$ 16,425	\$ 14,265
<u>Expenses:</u>			
I. Management & Office Expenses			
a) Directors Fees	\$ 1,200	\$ 1,200	\$ 1,200
b) Bookkeeping	600	600	600
c) Collection Expense	48	216	270 <sup>(2)</sup>
d) Rent	600	600	600
e) Fee Expense EPA	10	-0-	-0-
f) Interim Financing	-0-	1,332	-0- <sup>(3)</sup>
II. Sewage System Operations			
a) Routine O & M (Contract)	1,300	2,400	2,400
b) Repairs	588	2,500	1,200 <sup>(4)</sup>
c) Sludge Hauling	-0-	875	375 <sup>(5)</sup>
d) Plant Supplies	682	750	682 <sup>(6)</sup>
e) Service Charges	427	-0-	427 <sup>(3)</sup>
f) Utilities - Electric	1,695	1,865	1,695 <sup>(7)</sup>
g) Utilities - Water	1,182	1,182	1,182
h) Water Analysis	-0-	160	160
i) Miscellaneous Expense	-0-	24	-0- <sup>(8)</sup>
III. Other Expenses			
a) Engineering Fees - URC	-0-	250	-0- <sup>(9)</sup>
b) Engineering Fees - REG	-0-	100	-0- <sup>(9)</sup>
c) Legal Fees - URC	-0-	300	300
d) Legal Fees - REG	131	130	130
e) Accounting Fees - URC	-0-	200	200
f) Accounting Fees - REG	218	225	225
g) Insurance	246	246	246
h) Interest Expense	270	-0-	270 <sup>(3)</sup>
i) Tax & License	285	285	285
j) State & Federal Tax	-0-	85	85
Total Operating Expenses	\$ 9,482	\$ 15,525	\$ 12,532
Net Operating Income - (Loss)	\$ (8,267)	\$ 900	\$ 1,733

- (1) "Per Books" and "Proforma Requested" income and expenses were taken from the Applicant's Comparative Income Statement.
- (2) The request for \$216.00 in collection expense has been increased based on the Commission's determination of the actual billing expense multiplied by the number of customers found reasonable.
- (3) The request for \$1,332 in interim financing was disallowed based on the Commission's determination that most of the expenses were prior year claims and should not be charged against the customers new rate. However, \$427 in service charges and \$270 on interest expense were allowed although not requested as separate items in the Applicant's proforma requests.
- (4) The Applicant's request for \$2,500 in repairs was reduced to \$1,200 on the Commission's determination that even though the 25,000 gallon plant is 10 years old, the evidence for \$2,500 in repair expense was not sufficient.
- (5) The Applicant's request for \$875 in sludge hauling expense was reduced to \$375 after conferring with Brentwood's Plant owner Carroll Cogan, and his accountant Doug Kottke.
- (6) The Applicant's request for \$750 in plant supplies expense was reduced to the test year figure of \$682 as they were considered to be speculative at best, and were not determined by the Commission to be a reasonable known and measurable adjustment to test year expenses.
- (7) The Applicant's request for \$1,865 in electric utility expense was reduced to the test year figure of \$1,695 as they were considered to be speculative at best, and were not determined by the Commission to be a reasonable known and measurable adjustment to test year expenses.
- (8) The Applicant's request for \$24 in miscellaneous expense was disallowed as the amount was considered to be speculative at best, and were not determined by the Commission to be a reasonable known and measurable expense.
- (9) The Applicant's request for \$350 in engineering fees were disallowed based on the Commission's determination that these expenses were not necessary in preparing the rate case, nor were these expense substantiated with any documentation.
- (10) Proforma customers based on the direct testimony of Mr. Carroll F. Cogan (Transcript, Page 6, Question 8).